91-1964

No.: .....

Supreme Court, U.S.
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In the Supreme Court
OF THE
United States

TERM,

HASSNEH INSURANCE COMPANY OF ISRAEL, LTD.,
Petitioner,

VS.

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES,
Respondent,

JOHN GARAMENDI INSURANCE COMMISSIONER
OF THE STATE OF CALIFORNIA
Real Party In Interest.

PETITION FOR WRIT OF CERTIORARI FROM THE SUPERIOR COURT OF THE STATE OF CALIFORNIA, FOR THE COUNTY OF LOS ANGELES

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

Whether the Respondent Court's decision that an insurance company's liquidation can serve as justification to deprive Petitioner the right to seek the common law and statutory remedy of rescission and to assert defenses to admitted fraud, constitutes a violation of Petitioner's due process and a denial of Petitioner's equal protection under the laws of the United States Constitution, Fourteenth Amendment?

Whether the Respondent Court's interpretation of California Insurance Code Section 1019 (the "rights fixed" statute), violate the due process and equal protection clauses of the United States Constitution, Fourteenth Amendment?

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DECISIONS BELOW

The Order of the Superior Court of California, County of Los Angeles, filed June 25, 1991, is set forth in the Appendix as Exhibit "1." The Order of the Court of Appeal of the State of California, Second Appellate District, filed July 25, 1991, denying Petitioner's Petition for

Writ of Mandate, Prohibition and Stay is set forth as Exhibit "2." The Order of the Supreme Court of the State of California, filed August 29, 1991, denying Petitioner's Petition for Review and Application for Stay is attached as Exhibit "3."

JURISDICTION

The Order appealed from herein was entered and filed by the Superior Court of the State of California on June 25, 1991. Pursuant to 28 U.S.C. Section 1257, this Court has jurisdiction to review the Order by Writ of Certiorari.

Appellate jurisdiction is appropriate because the Order of the Superior Court of the State of California is the highest State Court in which a decision in the suit could be had. *Virginia R. Co. v. Mullens*, 271 U.S. 220, 46 S.Ct. 526, 70 L.Ed. 915 (1926). Further, the Order appealed from is final and reviewable since it effectively determined the rights of the parties and ended the litigation. *Richfield Oil Corp. v. State Board*, 329 U.S. 69, 67 S.Ct. 156, 91 L.Ed. 80 (1946).

The Superior Court's characterization of its order as being "interim" is not determinative upon this Court's appellate review. *La Crosse Telephone Corp. v. Wisconsin Employment Relations Board*, 336 U.S. 18, 69 S.Ct. 379, 93 L.Ed. 463, (1948). The so-called "Interim Trial Ruling" in fact, deprives Petitioner the right to allege and prove fraud (which, for the purposes of the Trial Court Motion, was admitted and perpetrated against it) and rescission as defenses to claims being asserted against it. Therefore, the decision, in effect constitutes a final judgment since the Respondent Court's ruling effectively stripped Petitioner of its defenses without due process of law. *Republic Natural Gas Co. v. Oklahoma*, 334 U.S. 62, 68 S.Ct. 972, 92

L.Ed. 1212 (1948). Moreover, the Respondent Court's decision conflicts with previous rulings from the California courts on the same issue.[1]

STATUTE INVOLVED IN THIS CASE

The statute primarily involved that is the focus of this Petition is California Insurance Code Section 1019, which provides:

> Section 1019. Date of vesting of claimant's rights.
>
> Upon the issuance of an order of liquidation under Section 1016, the rights and liabilities of any such person and of creditors, policyholders, shareholders and members, and all other persons interested in its assets, including the State of California, shall unless otherwise directed by the court, be fixed as of the date of the entry of the order in the office of the clerk of the county wherein the application was made.

STATEMENT OF THE CASE

The issue presented to this Court through this Petition is of great significance within the context of the ever increasing number of insurance insolvencies throughout the United States. The Respondent Court's decision, in effect, condones the perpetration of fraud. Further, the Respondent Court's decision is, in essence, a blatant

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[1]In *Prudential Reinsurance Co. v. Superior Court*, 216 Cal.App.3d 1321, 265 Cal.Rptr. 386 (1989), *review granted*, 268 Cal.Rptr. 542, 789 P.2d 342 (1990), the California Court of Appeal, Division "4," reversed the Respondent Court's trial ruling, holding that reinsurers of the insolvent Mission were entitled to set-offs of reinsurance contracts under Insurance Code Section 1031.

effort to avoid confronting the salient issue: state's failures to provide effective regulation.

As the Report of the Congressional Subcommittee on Oversight and Investigations dated February, 1990 pointed out, the rash of insurance insolvencies reflects the state's inability or unwillingness to provide effective regulation of the insurance industry. Indeed, as a result of its investigation, the Congressional Subcommittee found that the collapse of the Mission Insurance Companies was due to reckless and incompetent management; several types of fraudulent activities including reserve suppression, providing false reports to regulators and the public, bad faith dealing, and outright lies. A copy of the Congressional Report entitled "Failed Promises" is attached as Exhibit "7."

The claims of fraud asserted by the reinsurers, including Petitioner, have been validated by the Congressional Subcommittee in addition to being validated by the Respondent Court. In essence, the Respondent Court's decision sanctions admitted fraud. This decision, if it stands, will substantially impair state regulation of the insurance industry because regulators will have little or no incentive to monitor companies that are engaged in false and deceptive practices. Under this ruling, regulators would have to seek recourse against the victims rather than the perpetrators.

The illogic of the Respondent Court's decision in effect penalizes the victims, in this case, Petitioner, by depriving it of its constitutional right to seek common law and statutory remedies and to assert common law and statutory defenses. Further, neither California Insurance Code Sections 1019, 331 and 359, nor California Civil Code Section 1689 specifically abrogate these rights.

Petitioner is among 28 defendants currently in this action, comprising of foreign and domestic insurance companies. The Plaintiff and real party in interest is John Garamendi, the California Insurance Commissioner ("Commissioner"). The Commissioner placed the Mission Insurance Companies ("Mission") into liquidation in February, 1987. The Complaint in this action (Case Number C 683 233) was filed on April 15, 1988. The Commissioner is suing the defendants for payment of losses on reinsurance treaties allegedly ceded by Mission to the Defendants. Petitioner denies any liability on several grounds, including that it was defrauded by Mission and its subsidiary Pacific Reinsurance Management Corporation ("PRMC"). For the purposes of its ruling, the Respondent Court accepted as established all the facts that prove a fraud as set forth in the Offers of Proof filed by the defendants. (A copy of Petitioner's Offer of Proof is attached as Exhibit "4").

PRMC acted as a reinsurance pool manager for numerous foreign and U.S. reinsurance companies from 1970 through 1984. It created a separate pool for each year, the intention being that premiums and losses for reinsurance treaties incepting or renewing during a particular pool year were attributable to that pool year. In order to induce participation of its pools, PRMC grossly understated its historical loss ratio knowing that its past performance would be of material concern to prospective and renewing pool participants. PRMC also represented and warranted that it adhered to various strict underwriting guidelines and generally followed a conservative underwriting philosophy, promising that certain classes of business would not be written. To the contrary, PRMC intentionally wrote vast amounts of the very kind of high risk business which it knew was unauthorized, and which would result in catastrophic losses, but which neverthe-

less achieved its immediate premium goals and increased its own profitability.

Unbeknown to most pool members, and contrary to the direct instructions given to PRMC by some pool members, the reinsurance contracts written through PRMC were "fronted" by Mission, that is, Mission became the direct reinsurer of all the ceding companies and PRMC, on behalf of its affiliate Mission, retroceded (passed on) the reinsurance assumed by Mission to the PRMC pool participants. Mission therefore, had initial direct liability for the reinsurance contracts that were arranged by PRMC and "backed" through the alleged retrocessions with the various pool participants.

Mission knew the secret fronting agreement was unauthorized and conspired with PRMC to conceal the existence of that arrangement from certain pool participants. With Mission's knowledge, PRMC also falsely represented to pool participants that the reserves it was establishing were adequate. Both Mission and PRMC knew, however, that the opposite was true and that the reserves were grossly deficient. Indeed, based on information PRMC shared with Mission (but not with the other pool members), Mission secretly established additional reserves for its own net participation in the PRMC pools.

PRMC's "Ponzi-like" growth scheme began to unravel by 1983-1984. Unable to achieve sufficient premium income to offset the staggering losses continued to mount, and during 1984-1986, the reinsurers (Petitioner) demanded an explanation for the disastrous results. Investigations performed by several reinsurers revealed both fraud and gross mismanagement by Mission/PRMC, and payment of losses by Petitioner was suspended (or, as the case may be, determined).

On February 20, 1991, the Commissioner filed a Motion in Limine Re: Motion for Judgment on the Pleadings seeking to exclude any evidence at trial on the issue of rescission and an order that rescission is not available as a remedy to defendant reinsurers. (A copy of said Motion is attached as Exhibit "5," and Petitioner's Opposition thereto is attached as Exhibit "6"). Respondent Court issued its ruling granting the Motion (and sua sponte ordering further relief) on June 25, 1991. Three groups of Defendants separately filed Petitions for Writ of Mandate in the Second District Court of Appeals of the State of California. All three Petitions were summarily denied on July 25, 1991. Thereafter, all three groups of Defendants separately filed a Petition for Review with the Supreme Court of the State of California. This Petition was denied on July 26, 1991.

ARGUMENT

I.

A WRIT OF CERTIORARI SHOULD ISSUE BECAUSE THE RESPONDENT COURT'S ORDER IS A VIOLATION OF DUE PROCESS AND A DENIAL OF EQUAL PROTECTION OF THE LAWS.

A. There Is No Rational Basis To The Court's Interpretation Of Section 1019.

Although the McCarron-Ferguson Act, 15 U.S.C. Sections 1011-1015, exempts the insurance industry from Commerce Clause restrictions, it does not purport to limit in any way the applicability of the Equal Protection Clause. *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 105 S.Ct. 1676, 84 L.Ed.2d 751 (1985).

Under an equal protection analysis, a state law which regulates economic activity will be upheld if it bears a rational relationship to a legitimate state interest. *City of New Orleans v. Dukes,* 427 U.S. 297, 96 S.Ct 2513, 49 L.Ed.2d 511 (1976). *Williamson v. Lee Optical Co.,* 348 U.S. 483, 75 S.Ct. 461, 99 L.Ed. 563 (1955).

Accordingly, courts will defer to a legislative classification that affects only economic and not fundamental interest if the state interest is unquestionably legitimate and the classification is related to the statutory purpose for which it was made and does not result in invidious discrimination. *Burlington Northern R. Co. v. Dept. of Public Service Regulation,* 763 F.2d 1106, 1113 (9th Cir. 1985).

In ruling that Petitioner was not permitted to pursue the common law and statutory remedy of rescission, the Respondent Court relied upon California Insurance Code Section 1019,[2] finding that upon the order of liquidation of Mission in February, 1987, Petitioner's rights were "fixed" as a matter of law. Thus, any rights asserted against Mission before the order of liquidation were preserved, and any rights asserted after liquidation were deemed waived.

Section 1019 provides that upon the date of liquidation all rights and liabilities involving the assets of the insolvent company are fixed. This provision purports to serve three purposes: (1) to set the date to measure damages or loss; (2) to avoid any preference of one creditor over another in the distribution of assets without the consent of the receiver, and; (3) to prohibit future claims based on conduct after liquidation. *See generally, Carpenter v.*

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[2]All statutory references are to the California Insurance Code unless otherwise indicated.

Pacific Mut. Life Ins. Co., 10 Cal.2d 307, 74 P.2d 761 (1937), *aff'd. sub. nom. Neblett v. Carpenter,* 305 U.S. 297, 59 S.Ct. 170, 83 L.Ed.182 (1938) (discussing the importance of the Insurance Liquidation Code to protect the public from insolvent insurance companies.); *Caminetti v. Pacific Mut. Life Ins. Co.,* 23 Cal.2d 94, 102, 142 P.2d 741 (1943) (court determined the proper measurement of policyholders' damages after insolvency of insurer.); *Conway v. Plank,* 136 Misc. 403, 243 N.Y.S. 215, 216 (1930) ("The purpose of the [analogous New York] provision is to supply a definite date of settlement of the affairs of the company."); *Conway v. North Side Lumber Co.,* 141 Misc. 231, 252 N.Y.S. 476, 579 (1931) (analogous New York "fixed rights" provision refers to "to rights and liabilities on that date actually existing and matured, and not those which can only thereafter come into being. . .").

No interpretation of Section 1019 has been rendered by any State or Federal court which would impair any party to a contract with an insurer, which later becomes insolvent, from challenging the legality of that contract or seeking rescission. Yet without citing a single case decision, precedent or authority, the Respondent Court relied upon this very provision in denying Petitioner the remedy of rescission.

In its tortured and sweeping ruling, the Respondent Court utterly ignored overwhelming common law and statutory case authority supporting the right of a party to rescind a contract obtained by fraud. Even worse, the Respondent Court's ruling held that notwithstanding a finding of fraud, as a matter of law, Petitioner was not entitled to rescission.

The Respondent Court's interpretation of Section 1019 bears no rational relationship or justification for depriving Petitioner the common law and statutory right to

rescission of reinsurance contracts procured by fraud by the insolvent Mission. Instead, the Respondent Court ruling endorses and condones the fraudulent conduct of Mission to the prejudice of Petitioner, by rewarding and benefiting Mission for its fraud.

Clearly, the California legislature in enacting Section 1019 could not have reasonably conceived that the liquidator of an insolvent insurer would be permitted to benefit by the insolvent insurer's own fraudulent conduct.

Further, it is well established in every United States jurisdiction that a liquidator, receiver, trustee or other representative of an insolvent's estate takes the insolvent's rights and other assets subject to the claims and defenses to which they were subject while in the hands of the insolvent himself. As a result, the representative of the insolvent's estate is required to litigate on their entire merits and subject to all available defenses the claims he makes on behalf of the estate.

The rule is stated in *Downey v. Humphreys,* 102 Cal.App.2d 323, 336, 227 P.2d 484 (1951), as follows:

> A receiver occupies no better position than that which was occupied by the party for whom he acts. 'He takes the property and rights of the one for whom he was appointed precisely in the same condition and subject to the same equities as existed before his appointment, and any defense, good against the original party, is good against the receiver.

In the *Downey* case, the California Insurance Commissioner, as liquidator for an insolvent insurance company, sued an agent of the insurance company for unremitted insurance premiums. The Court of Appeal, noting the "fixed rights" provisions of the Insurance Code, held that

the agent was entitled to set off against the Insurance Commissioner's claims that commissions earned by the agent, as well as unearned premiums on policies issued by the insolvent insurance company. Because of the "fixed rights" provisions of the Insurance Code, the Insurance Commissioner's claims were subject to all the same defenses and equities, including set-off, as they were in the hands of the insolvent insurance company prior to liquidation. (*Id.* at 337). *See also, People v. California Safe Deposit & Trust Co.,* 168 Cal.241, 141 P.1181 (1914); *Camerer v. California Savings & Commercial Bank,* 4 Cal.2d 159, 48 P.2d 39 (1935), (liquidator of insolvent bank "takes the insolvent's property subject to all liens, defense, and equities to which it is subject in the hands of the insolvent, and . . . administers on behalf of creditors no greater title or estate than the debtor had.") *First Nat. Bank of Stockton v. Pomona Tile Mfg. Co.,* 82 Cal.App.2d 592, 608, 186 P.2d 693 (1948) (assignee for benefit of creditors "is not a purchaser for value and has no greater rights with respect to things in action transferred by the assignment than his assignor had . . . the assignee simply stands in the shoes of his assignor.") *Allen v. Ramsey,* 179 Cal.App.2d 843, 849-850, 4 Cal.Rptr. 575 (1960) ("Any action brought by a receiver is subject to the same defenses that might have been pleaded against the receivership defendant had no receiver been appointed.")

The rule in other jurisdictions is the same. For example, in *Kelly v. Bremmerman,* 23 A.D.2d 346, 260 N.Y.S.2d 971 (1965), the Appellate Division of New York Supreme Court dismissed a claim by the Pennsylvania Insurance Commissioner for an assessment against a member of an insolvent mutual insurance company which the Commissioner was liquidating. The insurance contract between the defendant and the insolvent insurance company required that assessment claims be brought within a speci-

fied time but that contractual limitation period had been exceeded. Noting that the right to levy an assessment arose from the member's contract of insurance, the court stated:

> The statutory authorization for the appointment of the plaintiff Insurance Commissioner as liquidator provides that the Commissioner 'shall be vested by operation of law with title to all of the property, contracts, and right of action of such company . . . as of the date of the order so directing him to liquidate.' [Citation omitted.] Thus, the liquidator succeeded to all the rights of the company as of the date of the order of liquidation, but she acquired no additional rights from the statute or the order.

Id. at 349.

In *McNamee v. APS Insurance Agency, Inc.*, 112 Wis.2d 329, 332 N.W.2d 828, (1983), the Wisconsin Court of Appeals upheld dismissal of a liquidator's claim, for return of unearned premiums, against an agent of the insolvent insurance company, All-Star. The court noted that the agency agreement between All-Star and the agent, APS, only required that APS return commission it had received in relation to premiums whose return to the insured had been "allowed" by All-Star. If All-Star had remained solvent, it would not be entitled to the return from APS of the unearned commissions because there had been no determination made that the insured's claim for return of premiums should be "allowed." Accordingly, neither was the liquidator, "because the liquidator stands in the shoes of the insurance company and is bound by its contracts." (*Id.* at 334).

In *Keehn v. Excess Ins. Co.*, 129 F.2d 503 (7th Cir. 1942), the Federal Court of Appeals, applying Illinois

law, upheld dismissal of a claim made against a reinsurer by the receiver of an insolvent insurance company. The insurance company had failed to give the reinsurer the notice of claim required under the reinsurance contract. The court held that the receiver was in no better position than the insolvent insurance company, stating:

> Plaintiff also advances a theory that because the suit was instituted by him as Receiver, he had greater legal rights than the corporation would have had if the suit had been instituted by it. In other words, it is contended that some sort of an estoppel should be invoked in the instant situation, which admittedly could not have been done against the corporation. We do not believe this position is tenable. The Receiver was appointed January 11, 1937. Long prior thereto, as pointed out heretofore, the claim against the defendant was barred for failure to give notice of loss in accordance with the terms of the insurance contract. We know of no rule of law which will permit the maintenance of a suit by a Receiver which was barred at the time of the Receiver's appointment. Under such circumstances, so we think, a Receiver acquired no greater right than that had by the Corporation at the time of his appointment.

Id. at 506.

California law clearly holds that an insolvency proceeding brought by a state agency does not operate to deprive defendants of their rescission-related defenses. In *Verder v. American Loan Society,* 1 Cal.2d 17, 32 P.2d 1081 (1934), a decision that is closely analogous with this action, the plaintiff sought to rescind a transaction with the solvent loan society. The liquidator argued that the creditors of the loan society were innocent third parties with intervening rights, which defeated the plaintiff's

rescission claims. The Court rejected those assertions, holding that in the absence of certain specific conditions, "*it is the declared law in California that the right to rescind is not to be denied on the mere fact of insolvency of the corporation . . .*" *Id.* at 31 (emphasis added).

Similarly, a New York court has recently held that reinsurers were entitled to rescind fraudulently induced treaties even as against the liquidator of the insolvent insurer who had committed the fraud. *Union Indemnity Insurance Co. of NY (Michigan National Bank v. American Centennial Insurance Co.),* Slip Opinion Index #41292-85, I.A. Part 27 (S.Ct. Justice Gammerman, N.Y. Co. NY Law Journal, October 25, 1989). The court held that since the reinsurer had been fraudulently induced to enter into the reinsurance treaty by the ceding company's concealment of its true financial condition and its methods of operation, the reinsurer could rescind the treaties as against the ceding company's liquidator.

In short, there is no known California authority where the right of rescission and the defense of fraud were lost simply because of an insolvency.

i. The Analogy to Bankruptcy.

The California Insurance Code's provisions on insolvency are similar to corresponding Bankruptcy Code provisions, and the two are often applied together. For instance, Section 1031, concerning set-offs, closely resembles Bankruptcy Code Section 553, concerning set-offs. The court in *Downey v. Humphreys, supra,* noted the similarity between these provisions of the Insurance and Bankruptcy Codes. *Id.* at 336. In *O'Connor v. Insurance Co. of North America,* 622 F.Supp. 611 (N.D. Ill. 1985), the court found federal bankruptcy principles to be valued precedent for insurance company liquidations. Both

codes contain provisions for filing proofs of claim (Sections 1023-1027; Bankruptcy Code Section 502), preference/priority of creditors (Section 1033; Bankruptcy Code Section 507); and handling of secured claims (Section 1029; Bankruptcy Code Section 506).

In adjudicating on an insurance company's insolvency, the California court in *Downey* employed the principle shared by insurance and bankruptcy law that "[a] receiver occupies no better position than that which was occupied by the party for whom he acts." *Downey,* 102 Cal.App.2d at 336. (Compare Bankruptcy Code Section 541, "Legislative History," paragraph 2 (Collier ed. 1991) (the trustee of the insolvent's estate can "take no greater rights than the debtor himself had.")) Similarly, the New York court in *Ris v. Nat'l Union Fire Ins. Co. of Pittsburgh,* 1989 U.S. Dist. LEXIS 7463 (S.D.N.Y. 1989), a bankruptcy case, employed New York insurance law in finding that the material-misrepresentations of the insolvent plaintiff in applying for an insurance policy entitled the defendant insurance company to rescind the insurance contract with the bankrupt, in spite of the fact that creditors were thus deprived of the insurance proceeds that the insolvent plaintiff sought.

In the bankruptcy context, a person may rescind a contract fraudulently obtained by the bankrupt and reclaim his money or goods. The reasoning behind this rule is that anything held by the bankrupt as a result of fraud is merely held by him in "constructive trust" for the rightful owner and is not part of the bankruptcy "estate" to be split amongst creditors under the Bankruptcy Code Section 541. Because the bankruptcy trustee takes only what the bankrupt had, the trustee has only a constructive trust over the fraudulently obtained funds or goods until the rightful owner can reclaim them. *See, e.g., In re North*

American Coin & Currency, Ltd., 767 F.2d 1573, (9th Cir. 1985). The court *In re Stridacchio*, 107 F.Supp. 486 (D.N.J. 1952), stated the policy underlying the rule:

> Where goods are obtained by fraud of the bankrupt, the seller may rescind the contract of sale and reclaim them if he can identify them in the hands of the trustee. This is only the theory that fraud renders all contracts voidable, and that neither in law nor in morals would the trustee be justified in holding goods obtained by the fraud of the bankrupt for the benefit of other creditors. Such creditors have no right to profit by the fraud of the bankrupt to the wrong and injury of the party who has been deceived and defrauded.

Id. at 487.

The *Stridacchio* court addressed the Respondent Court's decision that in this case, rescission of the contract would result in Petitioner and other defendants jumping ahead of "other creditors." The court stated that the rule does not result in a "preference" being obtained by the defrauded party, for that party must establish fraud to the satisfaction of the court before being allowed to take back what is rightfully his property, not an asset of the estate to be distributed amongst creditors. *Id.* at 487.

See also, *Bank of Marin v. England*, 385 U.S. 99, 101, 87 S.Ct. 274, 17 L.Ed.2d 197 (1966) (a trustee in bankruptcy "succeeds only to such rights as the bankrupt possessed; and the trustee is subject to all claims and defenses which might have been asserted against the bankrupt but for the filing of the petition.")

The Respondent Court's interpretation of Section 1019 is unsupported by its plain language and inconsistent

with decisions rendered by other jurisdictions with this similar provision. Nothing in the statute requires, much less purports to authorize, extinguishing rights that accrued as of the date of liquidation. To the contrary, those rights are by the very language of the statute "fixed" as of the date of liquidation. A settled principle of statutory construction is that in determining the intent of the legislature, courts should "first look to the words of the statute themselves, giving them their usual and ordinary meaning." *City of Santa Cruz v. Municipal Court*, 49 Cal.3d 74, 260 Cal.Rptr. 250, 776 P.2d 222 (1989). Nothing in Section 1019 negates defenses available under statute and case law. The language plainly preserves all defenses existing at the date of liquidation.

Notwithstanding a finding of admitted fraud by Mission, the Respondent Court's erroneous interpretation of Section 1019 in denying Petitioner's the common law and statutory right of rescission bears no rational relationship to the governmental interest of preserving the assets of insolvent estate by fixing the rights and liabilities of the insolvent Mission and the "claimants," and therefore, a denial of Petitioner's equal protection of the laws.

B. The Respondent's Court Ruling Is A Denial of Petitioner's Constitutional Right Of Due Process.

Like equal protection, a statute regulating economic activity challenged under due process will be upheld if it bears a rational relationship to a legitimate state interest. *Brandt v. State Farm Mut. Auto Ins. Co.*, 693 F. Supp. 877, 883 (E.D.Cal. 1988). To that extent, Petitioner's incorporate the above arguments.

In addition, due process mandates that a judicial proceeding give all parties an opportunity to be heard on the critical and decisive allegations which go to the core of

the parties claim or defense and to present evidence on the contested facts. *Complaint of Bankers Trust Co.*, 752 F.2d 874, 890 (3rd Cir. 1984).

The Constitutional guarantee of due process guarantees that any person against whom a claim is asserted in a judicial proceeding shall have the opportunity to be heard and to present his defenses. *Motores de Mexicali v. Superior Court*, 51 Cal.2d 172, 331 P.2d 1, 2 (1958).

Similarly, due process is absent if a party is denied the right to have his cause tried and determined in accordance with the procedures that are applied in other cases of like character. *Collins v. Superior Court*, 145 Cal.App.2d 588, 302 P.2d 805, 809 (1956).

As demonstrated above, the Respondent Court ignored established and controlling common law and statutory law on Petitioner's right of pursuing the remedy of rescission of contracts obtained by fraud, and therefore, a violation of Petitioner's due process rights.

II.

CONCLUSION

Petitioner has established that the Respondent Court erroneously applied Section 1019 in violation of Petitioner's due process and equal protection of the laws under the U.S. Constitution, Fourteenth Amendment. The Petition for a Writ of Certiorari should therefore be issued.

DATED: November 25, 1991

KROLL & TRACT
SOL KROLL
ELLIOTT M. KROLL
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By: _____

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APPENDIX A

APPENDIX A

SUPERIOR COURT OF CALIFORNIA, COUNTY OF LOS ANGELES

DEPT. 67

Date: June 25, 1991, Honorable Kurt J. Lewin, Judge; L. Rivas, Deputy Clerk.

JOHN GARAMENDI, Insurance Commissioner of California, etc.

DANIEL E. LUNGREN
RUBINSTEIN & PERRY
Counsel For Petitioner

VS.

ABEILLE-PAIX REASSURANCES, et al.
and RELATED CROSS-ACTIONS

NATURE OF PROCEEDINGS:
RULING ON SUBMITTED MATTER
ON THIS MATTER, HERETOFORE ARGUED AND SUBMITTED;
THE COURT NOW RULES AS FOLLOWS:
RULING ON SUBMITTED MATTER AND INTERIM TRIAL RULING

Counsel for the Commissioner as Liquidator for Mission made Motions in Limine Re: Judgment on the Pleadings etc. Thereafter the Court commenced the Trial and required defendants to make Offers of Proof regarding the availability of rescission and/or fraud defenses.

The Offers of Proof submitted are more detailed but wholly consistent with the allegations of defendants' pleadings and are taken by the Court as established for purposes of this ruling. The Court now makes the follow-

ing ruling which encompasses those legal issues, however raised, for the reasons which follow and for all the reasons set out in plaintiff's moving and supporting papers which are incorporated herein:

(a) Rescission of the reinsurance agreements which made it possible for Mission to issue policies beyond required reserves is not available.

(b) Defendants may not assert fraud as a defense to the enforcement of the agreements described in (a) above against the Commissioner as liquidator of Mission, because, as more particularly set out below, defendants could not justifiably rely on fraudulent misrepresentations regarding the placement of their reinsurance participation, or upon alleged misrepresentations contained in the said reinsurance agreements; and because the defense is not available against the Commissioner as liquidator of Mission or policyholders as real parties in interest.

All of Defendant reinsurers' offers of proof are substantially the same. Although the time periods and duration of participation vary from one to the other, defendants all assert that they were induced to enter and continue in the PRMC pool in reliance upon various misrepresentations made to them by principals of PRMC and Mission. The asserted misrepresentations are presented in excruciating detail much of it in technical esoteric industry terms. Throughout all of the Offers of Proof, however, the evidence reduces to representations of how PRMC would place defendants' respective participation in the reinsurance business.

Defendants' participation in the PRMC pool continued profitably for many years, and enabled Mission to issue policies against its reserves far in excess of what it could have issued had it not been able to "lay off" the risks it

reinsured with defendants through PRMC. During the "good years" defendants appear to have taken an ostrich-like posture of "don't tell us anything we don't want to know," while they collected lucrative premiums. In effect defendants delegated their respective underwriting decisions to PRMC. Vis-a-vis Mission in the hands of its liquidator and Mission's policyholders, PRMC was essentially more defendants' agent than an independent contractor.

As Mission approached financial difficulty from, among other causes, an increasing number of claims resulting from the questionable but profitable risks it had written, defendants finally began to make the inquiry they should have made initially, and repudiated all of their reinsurance obligations to Mission.

Under the foregoing circumstances, as between Mission and its policyholders, and defendants, defendants were not entitled to rely on the asserted misrepresentations as a matter of law. Defendants entered into reinsurance agreements selected for them by their delegate. Such reinsurance obligations would obviously have an immediate impact on purchasers of insurance issued by any ceding company without regard to its identity. Defendants cannot avoid the losses incurred by insureds under any policy the issue of which was made possible by PRMC's placement of any of defendants' reinsurance participation. Defendants cannot be permitted to abdicate their obligations to the ultimate insureds by blindly delegating their respective underwriting determinations to PRMC or anyone else. As pointed out above PRMC was in the posture of agent to defendants as principles and acting within the scope of its authority. Any fraud or breach of the participation agreements may be asserted by defendants against PRMC or Mission, but only in the

context of an action between a principle and his agent. Even taking those claims as established by defendants' Offer of Proof, as a matter of law, they cannot be interposed as bases for rescission of defendants' reinsurance agreements or as a defense to the Commissioner's actions to enforce those agreements.

Insurance Code §§ 1010 et seq. provides a comprehensive scheme for the treatment of all insurers and claimants in California in the event of insolvency. To the extent that other statutes, rights or remedies, legal or equitable, conflict with that scheme they must be reconciled and applied in a manner that preserves the intent of the insolvency provisions as well as those rights. *A fortiori,* where, as here, the parties asserting conflicting rights are insurance companies which have been permitted to participate in the business of insurance in this State whether or not admitted. Defendants by their posture in this action seek to arrogate to themselves a preference not available to anyone else who has or will suffer a loss as a result of Mission's insolvency. They assert that they only seek to avoid the impact of the egregious fraud perpetrated against them by the principles of PRMC and/or Mission. But whatever the misconduct might have been, to the extent that it caused the failure of Mission, all persons who suffered a loss as a result of that failure have been injured. The Legislature, in its wisdom, has determined in what manner and to what extent all those persons shall participate in what the Commissioner can salvage of the insolvent's assets.

Defendants argue as though they were the only victims of the fraudulent conduct cataloged in their Offers of Proof. They argue that no third party is, has or will be effected because they only insured Mission. Therefore, they go on to argue, the authority for the proposition that

rescission may be denied if the rights of third parties have been irrevocably effected, has no application to them. Defendants' position constitutes an unjustified self-serving focus on particular conduct which was only one part of the conduct of Mission principals (including PRMC principals), and a fictitious limitation of their reinsurance agreements; a limitation that seeks to exclude Mission's policyholders, many of whom became such as a result of defendants' reinsurance agreements, and the real parties in interest represented by the Commissioner as liquidator. The fact is, that whatever actionable wrong Mission or PRMC personnel may have perpetrated vis-a-vis these defendants, it was only a small part of the overall conduct which led to Mission's failure and so profoundly effected all of its policyholders. The actual and inevitable effect of Mission's and PRMC's procurement of reinsurance from these defendants enabled Mission to write policies far in excess of those it could have written if limited to its own reserves. This fact was apparent to any participant in the business of insurance including defendants here. Thus, in the most real terms, every insured of the Mission Companies is an innocent third party whose rights would be directly, substantially and adversely effected by the granting of the remedy of rescission. Defendants Offer of Proof that they were misled as to the placement of their participation in the pool with Mission does not alter the unavailability of rescission, because the foreseeability of the precise identity of effected third parties is not a factor. (In any event the existence of "insureds" as a class was certainly foreseeable even though the precise identity and risks might not have been known.)

It is precisely this type of situation contemplated by the rights fixing provisions of *Insurance Code § 1019*. At the time of the liquidation order the rights of these defendants were fixed and limited to the rights specified

in the insolvency provisions of the *Insurance Code*. Rescission is not included in the statutory scheme because it would create a preference wholly inconsistent with the priorities carefully articulated in § 1033. This Court has already ruled that reciprocal insurance agreements cannot be cleverly employed to circumvent those priorities; *a fortiori* a remedy which finds its roots in equity cannot be so employed. Defendants' claim to rescission would have that effect.

Nor does this deprive defendants of the statutory right to rescission as contained in *Civil Code §§ 1689 et seq.* The right is not absolute and the Court has discretion to impose conditions in conjunction with the granting of the remedy.

> "If in an action or proceeding a party seeks relief based upon rescission, the court may require the party to whom such relief is granted to make any compensation to the other which justice may require and may otherwise in its judgement adjust the equities between the parties." *Civil Code § 1692*

Having enabled Mission to write policies which would have been far in excess of its reserves in the absence of defendants' reinsurance agreements it is no longer possible to even approximate the status quo ante. Mission (or any ceding company) cannot "unwrite" the policies under which claims have been made or losses incurred but not reported (IBNRs). Any underwriter issuing reinsurance understands that once the ceding company writes policies legally permissible only as a result of the existence of reinsurance, rescission is no longer possible from the time the ceding company is unable to cure the deficiency in its reserves which would instantly result from rescission of any reinsurance agreement.

Under these circumstances "justice" requires that defendants first perform their obligations as to claims made and IBNRs as a condition to the granting of any "relief based upon rescission." (*Civil Code § 1692*) In that manner, defendants rights regarding redress for fraud, breach of fiduciary duty, breach of contract, negligent misrepresentation and all attendant remedies are preserved but reconciled with the insolvency provisions of the *Insurance Code* by requiring the assertion of those rights to follow sequentially the enforcement of the insurance agreements. This will of course mean that defendants will be relegated to stand with all other priority six claimants to collect any judgment they might obtain in this action, but that applies across the board to all claimants and is the unfortunate result of any insolvency. Not only will this approach reconcile the insolvency provisions with general law, but it will also avoid an unfair and unjustified preference for these defendants. Furthermore, even if defendants' abdication of their underwriting and business judgment was no more that negligent, it nevertheless helped make it possible for Mission to issue policies to its insureds in excess of required reserves. Thus as between defendants and the insureds, it is consistent with established principles of law that defendants bare any resulting loss.

> "Where one of two innocent parties must suffer by the act of the third, he, by whose negligence it happened, must be the sufferer." *Civil Code § 3543*

Thereafter their fraud claims can be adjudicated, and, if established they can be paid pro rata with all the other claims by others injured by any machinations of the principals of Mission and/or PRMC which led to the liquidation of the Mission companies. Any lesser condition would result in an unfair and unjustified preference

to defendants; hardly just or equitable as contemplated by section 1692.

A COPY OF THIS MINUTE ORDER IS MAILED THIS DATE BY U.S. MAIL ON RUBINSTEIN & PERRY FOR SERVICE ON ALL PARTIES.